

## Message Text

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61

ACTION EUR-25

INFO OCT-01 IO-14 ISO-00 SWF-02 AID-20 CEA-02 CIAE-00

COME-00 EB-11 FRB-02 INR-10 NSAE-00 RSC-01 CIEP-02

SP-03 STR-08 TRSE-00 LAB-06 SIL-01 SAM-01 OMB-01

FEA-02 NSC-07 SS-20 NEA-14 L-03 DRC-01 /157 W

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R 211741Z JUN 74

FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC 7094

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY THE HAGUE

USMISSION GENEVA

USMISSION OECD PARIS

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PASS TREASURY, FRB, CEA

E.O. 11652: N/A

TAGS: EFIN, EC

SUBJECT: EC COMMISSION CONSIDERATION OF RECYCLING, CONCERTED FLOATING,  
AND GOLD

REF: EC BRUSSELS 3090

1. SUMMARY: THE EC COMMISSION IS DRAWING UP SPECIFIC PROPOSALS  
FOR INTERNATIONAL BORROWING AND CONCERTED FLOATING--IDEAS WHICH  
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IT ORIGINALLY RAISED AT THE EC COUNCIL (FINANCE) MEETING JUNE 6

(REFTEL). ON THE PREMISE THAT THE INTERNATIONAL BANKING SYSTEM IS FACING SERIOUS PROBLEMS IN RECYCLING OIL REVENUES, THE COMMISSION IS WORKING SERIOUSLY ON A PROPOSAL FOR (A) THE

FLOATING OF A MAJOR COMMUNITY LOAN FOR MEMBER STATES IN DEFICIT, AND (B) THE CREATION OF A COMMUNITY FINANCIAL FUND THAT WOULD ACT AS A MAJOR BANK IN THE EURODOLLAR MARKET. ON CONCERTED FLOATING, THE COMMISSION IS REPORTEDLY TORN BETWEEN CREATION OF A NEW SNAKE (VIEWED AS HIGHLY IMPROBABLE) AND A MECHANISM FOR PLACING THE EXISTING MINI-SNAKE IN A "COMMUNITY" FRAMEWORK. THE COMMISSION HAS PREPARED A BRIEF STATUS REPORT ON GOLD--WITHOUT SPECIFIC PROPOSALS--BASED ON THE ZEIST PROPOSALS AND THE C-20 MEETING IN WASHINGTON. THE COMMISSION'S IDEAS ON THESE SUBJECTS ARE STILL VAGUE AND PRELIMINARY. THEY WILL BE DEVELOPED FURTHER IN PREPARATION FOR DISCUSSION BY THE COUNCIL (FINANCE) AT ITS NEXT MEETING JULY 15. END SUMMARY.

2. THE PROPOSALS ON RECYCLING, WHICH ARE STILL IN THE DISCUSSION STAGE, ASSUME A COMMUNITY DEFICIT OF \$18 TO \$20 BILLION PER YEAR, A NET SURPLUS OF OIL EXPORTERS OF \$60 BILLION A YEAR AND A EURODOLLAR MARKET OF AT LEAST \$160 BILLION. GROWTH IN EURODOLLAR CREDITS IS ESTIMATED AT \$12 BILLION DURING THE FIRST QUARTER OF 1974 AS COMPARED WITH \$21.5 BILLION IN ALL OF 1973.

3. THE PROPOSALS DRAW ATTENTION TO RECENT PROBLEMS OF THE EURODOLLAR MARKET IN RECYCLING--PARTICULARLY (A) VERY SHORT-TERM DEPOSITS (LESS THAN ONE MONTH); (B) PROGRESSIVE LOSS OF CONFIDENCE DUE TO THE ABSENCE OF A LENDER OF LAST RESORT; (C) GROWING RISKS OF A LIQUIDITY CRISIS IN THE TRANSFORMING OF SHORT-

TERM DEPOSITS INTO LONG-TERM LENDING; (D) CEILINGS ON DEPOSIT-ASSET RATIOS; AND (E) GROWING UNWILLINGNESS OF MANY INTERNATIONAL BANKS TO BORROW BEYOND CERTAIN LIMITS.

4. THE COMMISSION WOULD ENVISAGE TWO STEPS IN THE FACE OF THE ABOVE: THE FIRST WOULD BE THE PLACING OF A LARGE LOAN BY SOME COMMUNITY INSTITUTION WITHIN THE NEXT THREE OR FOUR MONTHS TO PROVIDE CREDITS TO DEFICIT MEMBER STATES ON CONDITIONS DETERMINED BY THE COMMUNITY. CONSULTATIONS WITH MAJOR BANKING GROUPS IN THE COMMUNITY CONCERNING SUCH AN OPERATION ARE LIMITED OFFICIAL USE

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REPORTEDLY UNDER WAY, AND THEIR REACTION IS VIEWED AS POSITIVE PROVIDED THAT THERE IS A MECHANISM FOR COMMUNITY RESPONSIBILITY OR THAT THE EC MONETARY COOPERATION FUND ACTS AS THE BORROWER, WHICH WOULD IMPLY COMMUNITY RESPONSIBILITY. THE SECOND STEP WOULD BE THE CREATION OF A COMMUNITY FINANCIAL FUND WHICH WOULD BE ABLE TO ACT AS A MAJOR BANKING ORGANIZATION IN THE EURODOLLAR MARKET. SUCH A FUND WOULD CONTRIBUTE GREATLY TO RESOLVING THE KEY PROBLEM OF DIFFERING MATURITIES ON THE BORROWING AND LENDING

SIDE. THE FUND WOULD TAKE DEPOSITS AND LEND TO A NUMBER OF INSTITUTIONAL BORROWERS. IT WOULD BE A PERMANENT ORGANIZATION WHICH WOULD BE OPERATED BY THE EUROPEAN INVESTMENT BANK WITHIN THE FRAMEWORK OF DIRECTIVES DETERMINED BY THE GOVERNORS OF THE BANK. THE COMMISSION'S PROPOSALS ENVISAGE THAT SUCH A FUND WOULD BECOME A MAJOR FACTOR IN THE LONG-TERM MARKET AND OPERATE INCREASINGLY IN THE EURO-BOND MARKET, ON WHICH IT COULD FLOAT LONG-TERM BONDS EVENTUALLY DENOMINATED IN A COMMUNITY UNIT ACCOUNT.

5. THE COMMISSION WOULD GIVE ABSOLUTE PRIORITY IN THE NEAR FUTURE TO MAJOR BORROWING AS DESCRIBED ABOVE WITH THE CREATION OF A FINANCIAL FUND FOLLOWING AS SOON AS POSSIBLE THEREAFTER. OVER A LONGER PERIOD THE COMMISSION WOULD CONSIDER THE POSSIBILITY OF A COMMUNITY INSURANCE SYSTEM MODELED ON THE FDIC.

6. ALTHOUGH THE COMMISSION'S IDEAS ON RECYCLING SEEM AMBITIOUS, OUR SOURCES TELL US THE COMMISSION IS SUFFICIENTLY IMPRESSED WITH THE GRAVITY OF THE PROBLEM TO PRESS ITS IDEAS WITH VIGOR AND DETERMINATION.

7. COMMISSION OFFICIALS ARE ALSO PREPARING PROPOSALS ON SOME FORM OF CONCERTED FLOATING. THESE RANGE FROM A MAXIMALIST APPROACH INVOLVING CREATION OF A NEW "SNAKE" TO A MINIMALIST

SOLUTION LIMITED TO SOME SORT OF COMMUNITY PARTICIPATION IN THE MANAGEMENT OF THE PRESENT MINI-SNAKE (THE FRG, DENMARK AND BENELUX, PLUS SWEDEN AND NORWAY). ALTHOUGH THERE IS SOME SUPPORT WITHIN THE COMMISSION FOR A NEW SNAKE, OUR SOURCES TELL US MOST COMMISSION MEMBERS HAVE REPORTEDLY REACTED NEGATIVELY-- AND WITH BEWILDERMENT--TO THIS RATHER SKETCHY PROPOSAL. THOSE WITH THIS ATTITUDE SAY THE TIME IS HARDLY RIPE FOR NEW MONETARY LIMITED OFFICIAL USE

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EXPERIMENTS AND INTERVENTION SYSTEMS--EVEN ASSUMING FLUCTUATION MARGINS CONSIDERABLY WIDER THAN THE CURRENT 2.25 PERCENT. LITTLE IS EXPECTED TO COME OF THIS INITIATIVE. ON THE OTHER HAND, THERE IS A STRONG DESIRE IN THE COMMISSION TO SEE AN END TO ADMINISTRATION OF THE MINI-SNAKE SOLELY BY THE PARTICIPATING NATIONS. THERE MAY THUS BE A SERIOUS EFFORT TO PLACE IT IN A COMMUNITY FRAMEWORK, WHICH WOULD IMPLY SOME COMMISSION PARTICIPATION AND BROADER CONSULTATION AMONG ALL THE MEMBER STATES.

8. AS YET THERE ARE NO CONCRETE COMMISSION PROPOSALS ON GOLD. COMMISSION SERVICES ARE DIGESTING THE AGREEMENT IN PRINCIPLE AT WASHINGTON ON USE OF GOLD AS COLLATERAL, TRYING TO DETERMINE PRECISELY WHAT WAS AGREED UPON AND ITS IMPLICATIONS, AND ASKING THEMSELVES WHERE THE COMMUNITY GOES FROM HERE. IT IS GENERALLY RECOGNIZED THAT ALL ANY OF THE NEEDIER MEMBER STATES REALLY WANT

IS REVALUATION OF THEIR RESERVES--PROPOSALS ON GOLD SIMPLY BEING A MEANS TO THIS END. THESE MEMBER STATES MAY THEREFORE BE EXPECTED TO PRESS FOR COMMUNITY PROPOSALS DESIGNED TO ACHIEVE THIS REVALUATION.

9. SO FAR THE COMMISSION HAS MERELY PREPARED A SHORT PAPER OUTLINING THE CURRENT STATUS OF THE GOLD ISSUE WHILE RETAINING THE COMMUNITY'S ZEIST PROPOSALS AS THE BASIS FOR EVENTUAL COMMUNITY INITIATIVES. ONE POINT ON WHICH THERE SEEMS TO BE UNANIMITY WITHIN THE COMMISSION IS THAT ANY SPECIFIC SOLUTIONS SHOULD NOT BE BILATERAL--SUCH AS A DIRECT ARRANGEMENT BETWEEN THE FRG AND ITALY--BUT RATHER SHOULD BE IN THE FRAMEWORK OF COMMUNITY INSTITUTIONS SUCH AS THE MONETARY COOPERATION FUND. ON THIS BASIS, ITALY'S GOLD WOULD BE PLEDGED TO THE FUND IN EXCHANGE FOR EC UNITS OF ACCOUNT.

10. THE EC COUNCIL (FINANCE) IS EXPECTED TO DISCUSS ALL THE ABOVE ISSUES AT ITS NEXT MEETING JULY 15. GREENWALD

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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** GOLD, PETROLEUM PRODUCTION, EURODOLLAR MARKET, LOANS, ECONOMIC PROGRAMS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 21 JUN 1974  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** golinofr  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1974ECBRU04422  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** N/A  
**Film Number:** D740164-0043  
**From:** EC BRUSSELS  
**Handling Restrictions:** n/a  
**Image Path:**  
**ISecure:** 1  
**Legacy Key:** link1974/newtext/t19740625/aaaaavkd.tel  
**Line Count:** 187  
**Locator:** TEXT ON-LINE, ON MICROFILM  
**Office:** ACTION EUR  
**Original Classification:** LIMITED OFFICIAL USE  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 4  
**Previous Channel Indicators:**  
**Previous Classification:** LIMITED OFFICIAL USE  
**Previous Handling Restrictions:** n/a  
**Reference:** EC BRUSSELS 3090  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** golinofr  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 04 APR 2002  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <04 APR 2002 by izenbei0>; APPROVED <18 JUN 2002 by golinofr>  
**Review Markings:**

Declassified/Released  
US Department of State  
EO Systematic Review  
30 JUN 2005

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** EC COMMISSION CONSIDERATION OF RECYCLING, CONCERTED FLOATING, AND GOLD  
**TAGS:** EFIN, EC  
**To:** STATE  
**Type:** TE  
**Markings:** Declassified/Released US Department of State EO Systematic Review 30 JUN 2005